

# Last in line

An assessment of consumer protection in the event of retailer insolvency



**citizens  
advice**

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# Introduction

Prepayments form a significant part of the retail economy. We routinely pay for a wide range of goods, from theatre tickets to furniture, weeks or even months in advance of receiving them. An estimated 24.5 million prepayments were made by 20 million customers in 2009.<sup>1</sup> There is good reason to believe that this number has increased significantly since then, in part due to the rise of e-commerce. Three quarters of UK adults bought or sold goods and services on the internet in 2014, up from 53 per cent in 2008<sup>2</sup> - the vast majority of which will have been paid for in advance.

Prepayments offer clear benefits for traders in the form of guaranteed payment and valuable cash flow, particularly when trading in high value goods. In the vast majority of cases people who have paid for goods or services in advance do not encounter a problem. But what happens when things go wrong? In this briefing note we use our unique evidence, gathered from across the Citizens Advice Service, to explore the consumer experience of prepayments and retailer insolvency.

In the first section we explore the political and legal context before setting out the findings of an analysis of 1,380 enquiries to the Consumer Helpline in relation to eight high profile retailer insolvencies in section two. We find that although retailer insolvencies are relatively rare, the financial and emotional impact for individual consumers can be severe. We also identify three problem areas ripe for reform:

- First, there is a significant gap between consumers' expectations and understanding of 'fairness' and the legal status and rights they are afforded in practice under insolvency law, leading to a strong sense of injustice among affected consumers.
- Second, the information given to consumers in the days and weeks after a retailer becomes insolvent is often incomplete and inconsistent. This makes it difficult for consumers to establish a clear picture of the routes to redress open to them and the steps they need to take to access them

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<sup>1</sup> Consumer Focus (2009) Pay now, Pay later.

<http://www.consumerfocus.org.uk/files/2010/12/pppl-final.pdf>

<sup>2</sup> ONS Internet Access – Households and individuals 2014

<http://www.ons.gov.uk/ons/rel/rdit2/internet-access---households-and-individuals/2014/stb-ia-2014.html>

- Finally, access to redress is not consistent across payment methods, leaving consumers that pay by cash, who are often those least able to absorb financial shocks, at increased risk of finding themselves out of pocket.

In the third and final section we weigh up the arguments and identify four key opportunities for aligning consumer protections more closely with consumer expectations significantly out of kilter with general principles of consumer rights:

1. Moving consumers up the hierarchy of creditors to the status of preferential creditors
2. Encouraging retailers to take steps to protect consumer prepayments
3. Greater clarity on the transfer of legal ownership of goods
4. Clear, consistent information and a single point of contact for consumers in cases of retailer insolvency.

# Section 1: Context

Concerns about prepayment are not new - no less than four reviews of the legislation in this area have been conducted since the 1980s.<sup>3</sup> Although each of these reviews recognised the risk to individual consumers and consumer confidence posed by the status of prepayments under insolvency law, opinion has been divided on whether a change to the law, and the status of consumers in the hierarchy of creditors, is justified. In practice little has changed.

A number of high profile cases during the recession brought the issue to the fore once again. This prompted the Department for Business Innovation and Skills (BIS) to ask the Law Commission to examine the protections given to consumer prepayments and consider whether these protections should be strengthened. To inform this review, the Law Commission asked Citizens Advice for evidence on the experience of consumers who have prepaid for goods and services which were not delivered or fulfilled due to the retailer's insolvency.

Retailer insolvencies are relatively rare and have fallen to 1,100 in 2014 from 1,454 during the peak of the recession in 2009.<sup>4</sup> However, consumer harm when retailers do become insolvent remains a real concern. In markets where prepayments for high value goods are particularly common, as in the case of furniture, consumer losses can be widespread and severe. Alongside the losses faced by individuals, high profile insolvencies have the potential to damage fragile consumer confidence, which is so vital to a thriving economy. In this note we present the evidence we gathered for the Law Commission in the hope that it can inform better consumer protections in time for the next major insolvency.

## The law

From the moment a company becomes insolvent, customers no longer have the legal right to receive goods they have paid for in advance or a refund on the balance they have paid. If a buyer for the business is found, the new owner may choose to honour gift cards and prepayments to avoid damaging the reputation of the brand, but they are under no legal obligation to do so. If a buyer is not found and the company enters administration the administrator may choose to

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<sup>3</sup> For example, The Cork Report 1982, OFT discussion paper 1984 and report in 1986 and the OFT's response to Farepack in 2006.

<sup>4</sup> Citizens Advice analysis of figures from Insolvency Service 'Insolvency Statistics January to March 2015'- Experimental statistics. Figures presented reached by combining 'compulsory liquidations' 'voluntary creditors liquidations' and 'administrations' in the category 'retail trade, except of motor vehicles and motorcycles'.

honour gift cards and prepayments but can only do so if they think it is in the interests of all of the business' creditors to do so.

If the new buyer or administrator decide not to honour existing contracts, customers assume the status of an unsecured creditor. Unsecured creditors sit at the bottom of the hierarchy of creditors when it comes to dividing up the assets of the company - the costs of the administrator, secured creditors and 'preferential creditors' such as employees who are owed wages must all be paid before unsecured creditors are even considered. Any remaining funds are distributed equally amongst all unsecured creditors, a category which includes consumers, utilities companies and landlords.

Until 2003 unsecured creditors often received nothing at all in cases of insolvency because the pot of money available to creditors ran out by the time creditors higher up in the statutory hierarchy had been paid. The Enterprise Act 2002 introduced a requirement that a proportion of an insolvent company's assets must be set aside for unsecured creditors, called 'the prescribed part', subject to a cap of £600,000. In practice, however, once the cost of administering claims is deducted from the 'prescribed part' and the remaining money is shared equally amongst all unsecured creditors, consumers received on average less than one pence for every pound they paid in the 31 retailer insolvencies analysed by the Law Commission.<sup>5</sup>

A consumer's chances of receiving a full or partial refund are significantly improved in cases where the retailer ring-fences consumer prepayments in a trust. This gives consumers what is known in legal terms as a 'beneficial interest' in the money. In practice, this means that if the retailer becomes insolvent the money in the trust fund is not considered an asset of the company and divided according to the hierarchy of creditors. It is instead returned to the consumers whose prepayments were paid into the fund.

Consumers who make a prepayment through a credit or debit card also enjoy additional protections through Section 75 of the Consumer Credit Act 1974 and the chargeback scheme respectively:

- Section 75 of the Consumer Credit Act, which applies to credit agreements only, allows consumers to hold their credit card issuer jointly liable in cases where the supplier of goods and services has misled the consumer or a breach of contract has occurred. Non-delivery of goods which have been paid for in advance constitutes a breach of contract, allowing

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<sup>5</sup> Law Commission (2015) *Consumer Prepayments on Retailer Insolvency. A Consultation Paper*.

consumers who have paid for their goods through a credit card to claim a full refund from their card issuer.

Even if the consumer only paid part of the payment through a credit card and, for example, pay the remaining balance in cash, the full value of any goods or services which cost between £100.01 and £30,000 can be claimed back from the credit card provider. Consumers in England and Wales have six years to make a claim.

- Chargeback is a scheme run voluntarily by Visa and Mastercard which allows transactions made by debit card or credit card to be reversed in particular circumstances, including cases in which goods which have been paid for in advance but not delivered. A consumer who has made a prepayment to a company which has become insolvent can make a claim to their card issuer, which will then credit the consumer's account if it believes that chargeback is appropriate. The card issuer may then reclaim that money from the merchant acquirer<sup>6</sup> under the chargeback scheme rules.

There is no limit on the value of the goods and services covered under the scheme. Chargeback is time limited, but the time allowed to make a claim varies between the schemes run by Visa and Mastercard and the details of these time limits is confidential. It appears that to maximise their chance of recovery, consumers should apply within three months of the expected delivery date to ensure that card issuers have sufficient time to evaluate their claim and complete the relevant procedures.<sup>7</sup>

In some sectors consumers may also receive some protection on deposits and prepayments under the codes of practice put in place by trade bodies. For example, subscribers to codes of practice approved by the Chartered Trading Standards Institute's Codes Approval Scheme are required to put in place mechanisms to protect deposits and prepayments. In practice, however, the scope of these protections is often limited, and there is no guarantee that consumers will receive a full refund on any prepayments made. In addition, only 14 codes of practice, with a total of 27,000 member businesses, have been through the codes approval scheme, leaving significant gaps in protection across the economy.

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<sup>6</sup> A merchant acquirer is a bank which processes and receives funds for credit and debit card transactions.

<sup>7</sup> Law Commission (2015) *Consumer Prepayments on Retailer Insolvency. A Consultation Paper*.

In the following section we turn to the consumer experience of securing redress in cases of retailer insolvency.



## Section 2: The consumer experience

Retailer insolvencies are not an everyday occurrence, but the impact on individual consumers and wider consumer confidence when a company goes bust can be severe. In this chapter we consider the human impact of retailer insolvency and the common problems faced by consumers in this situation.

Our observations are based on an analysis of evidence gathered from across the Citizens Advice service in relation to eight high profile retailer insolvencies which led to widespread media coverage. Due to restrictions placed upon Citizens Advice by part 9 of the Enterprise Act 2002 in relation to data gathered before April 2012 by the OFT, we cannot disclose the names of these companies.

Our analysis draws on two unique sources of data:

- **An analysis of 1,380 cases reported to the Citizens Advice Consumer Helpline.** Each year the Citizens Advice Consumer Helpline helps people with more than two million enquiries about a wide range of consumer problems. To extract the relevant cases from this vast data set, we conducted a keyword search to identify any cases which mentioned the name one of the eight traders under consideration anywhere in the case notes. We searched for cases in a period of one year from the date the trader entered administration.

The relevant cases were then searched for any mention of the words 'administration' or 'liquidation'. Cases mentioning these terms were then screened to ensure that they were relevant to the scope of the analysis, resulting in a final data set of 1,380 cases.

- Citizens Advice Bureaux advisers submit detailed descriptive accounts when a client's case is intractable and requires a change in policy, practice or law. Last year we received 50,000 of these '**Bureau Evidence Forms**' (BEFs). The case studies presented throughout this briefing are drawn from these BEFs and casenotes from the Consumer Helpline.

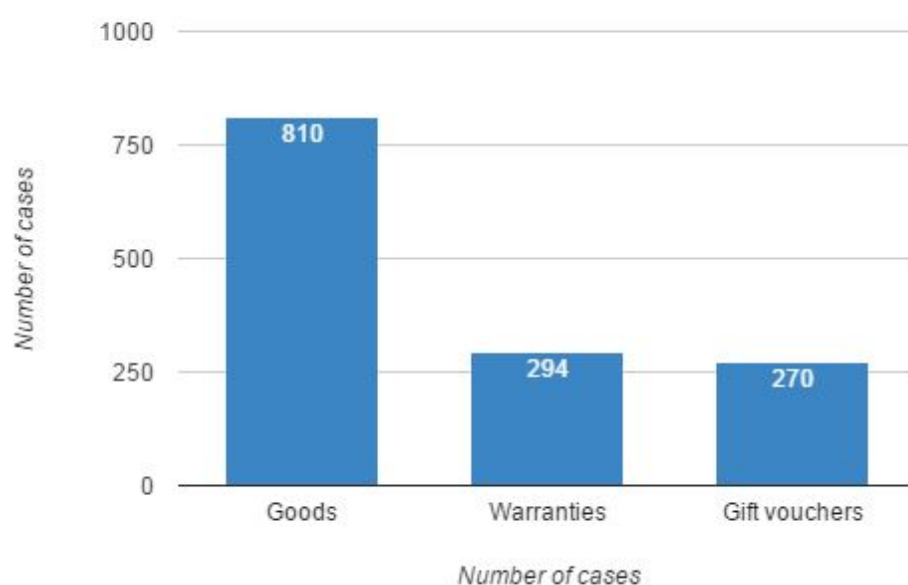
### The impact of retailer insolvency

In all but a handful of instances, the Consumer Helpline cases in our sample fell into one of three categories; goods, warranties and gift vouchers. Nearly 60 per

cent (810) of the cases in our sample related to goods which had been paid for but not delivered as a result of the company going into administration.

**Figure 1: Goods dominate in calls to the Consumer Helpline in relation to prepayments and retailer insolvency**

Number of calls to the consumer helpline in relation to prepayments and retailer insolvency by product type



▲Source: Citizens Advice analysis of data from the Citizens Advice Consumer Helpline

The average financial loss in cases related to goods was £698. The sums at stake varied significantly from trader to trader, reflecting the relative value of the goods being traded. For example, for one firm the average loss faced by customers was £12,000, compared to just £34 for another. Financial losses on this scale can have a significant impact on fragile household finances. For example:

*Laura told us that she had saved very hard to be able to purchase a new freezer after her old one had broken. She paid for the goods in advance but later discovered that she would not receive the goods because the retailer was now insolvent. Her family could ill afford to lose this money - they were solely reliant on her partner's income as Laura was a full time time carer for their disabled son. She asked our advisers: 'Please can someone tell me how I am*

*supposed to feed my family of four on such a low income with no freezer now?’*

A further 20 per cent (270 cases) of the cases in our sample concerned people who had found it difficult or impossible to redeem gift cards and vouchers once a trader had entered into administration. The mean loss to the consumer in these cases was £83, ranging between £273 and £64 across the traders included in the sample. This average is higher than we might expect due to a small number of cases which related to gift cards of an unusually high value. The median value of the giftcards in our sample was £30.

Concerns about whether extended warranties would be honoured accounted for a further 21 per cent (294 cases) of the sample. Warranties are not necessarily a form of prepayment, depending on the arrangements put in place, and so fall outside of the scope of this paper. The analysis and discussion below focus exclusively on the experience of those who have prepaid for goods, services and gift cards.

Alongside the impact on fragile household finances, our analysis revealed that retailer insolvency can have a strong impact on the emotional wellbeing of consumers too. For example, one client wrote the following in an email to the Consumer Helpline seeking advice on his grandmother’s behalf:

*“My grandmother purchased a cooker from a retailer last week, the following day they announced they were going into administration. She paid for the cooker installation and removal of her old cooker. When she rang them to ask if she would still receive the cooker she was told that she wouldn’t and that she also wasn’t going to get a refund. I’m sure you can imagine that this has been very stressful for her and being a pensioner she doesn’t need the stress. She also has no cooking facilities.”*

## **The types of problems people encounter**

The details of each case varied depending on the individual circumstances of the client and the type of trader. However, a sense of injustice, confusion and poor communication emerged as a common theme. This applied to three aspects of the consumer experience in particular: The financial status of the company, the transfer of legal ownership of goods and the process for redress.

### **The financial status of the company**

Unsurprisingly, few consumers have a detailed understanding of the intricacies of insolvency law. Callers to the Consumer Helpline are often shocked to discover that they no longer have the legal right to receive the goods and services they have paid for in good faith when the retailer becomes insolvent. A sense of injustice and confusion about the legal status and rights of consumers in this situation emerged as a common thread running through the cases we analysed. The following case is not untypical:

*"I purchased a sofa and armchair from a retailer in January 2014 for £1,000. I was told my estimated delivery date was at the end of March. I rang today to chase up my undelivered goods to be told I will not be getting my furniture nor a refund due to the company going into liquidation. I had no idea when I bought the furniture that I was at risk of losing so much money. I was unaware of the retailer closing down at all. I'm a single mum on income support and this financial loss has affected me greatly. I would hugely appreciate any help or advice as I'm genuinely at a loss."*

In many cases, the sense of injustice our clients felt was exacerbated by the fact that retailers often continued to accept prepayments in the weeks, and even hours, running up to the business being declared insolvent. By this point, consumers felt that the retailer must have known that they were unlikely to be able to fulfill the order and the customer's money was therefore at risk. For example, one man had bought a television and gas cooker on finance only to discover that the retailer had gone into liquidation *later that day*. Another man told us:

*"At Christmas I purchased £40 worth of vouchers as presents then a few weeks later they went into receivership the administrators say that the vouchers will not be honoured, but the stores are still open and trading, I feel as though I have been defrauded of my money."*

People found their legal position particularly hard to fathom in cases where the retailer had been bought out by another company. New buyers taking over an insolvent business are well within their rights to refuse to honour contracts made by the previous owners, including prepayments and gift cards. Customers can therefore find themselves in a situation where a company is trading under the same name, in the same stores with the same stock and yet they have no legal right to a refund or the goods they have paid for. One woman told us:

*"I have bought furniture from a retailer and there are 3 pieces (dining chairs, a bookcase and an office chair) I have not received, totalling just short of £1,000. Moreover, in the meantime the trader was bought back by one of its founders,*

*but the retailer now claims that it is a totally different company and will not honour any outstanding orders. However, they use the same name, the same website and the same Facebook page. They have even kept my online account with my contact details and sent me advertising emails and texts. Only my outstanding orders have disappeared from my online account. I don't understand how this is legal?"*

## The transfer of legal ownership of goods

The point at which the ownership of goods passes from the retailer to the consumer emerged as a further common source of confusion and dissatisfaction for our clients. Some of our clients could not understand why goods they had paid for, and in some circumstances even altered according to their specification, were not legally theirs. For example, one woman told us:

*"We ordered some curtains, paid for them and had them shortened by the shop. We had a phone call Tuesday evening to say they were ready for collection. We called in today (Thursday) to collect them and were told the shop had gone into receivership as of 12 noon yesterday (Wednesday) and that we couldn't have the curtains as they were assets of the company and the assets were frozen. Surely if we have paid for them, they are no longer the company's assets but they are our assets and we should have been able to pick them up. Had the staff been misinformed?"*

The law in this area is complex. Under the Sale of Goods Act 1979, the point at which ownership of the goods pass to the consumer depends on whether the goods are categorised as 'specific' or 'unascertained or future' goods:

- **Specific goods** are 'identified and agreed upon at the time a contract of sale' is made. As long as the goods are in a deliverable state and the contract of sale is unconditional, ownership of the goods passes to the consumer immediately. However, if the seller needs to alter the goods in some way, ownership may not pass on to the consumer until the alteration has been made.
- In many cases, and particularly when goods are bought online, the contract between the retailer and the consumer is made in advance of a specific item being identified to fulfill the contract. These goods are legally considered to be **unascertained goods**. For example, if a consumer orders and pays for a particular make and model of sofa online, the retailer

would not usually identify exactly which sofa would be used to fulfill that order, or set the chosen sofa aside for the customer, until it is due to be despatched. Goods which have not yet been manufactured are categorised as **future goods**.

Ownership of unascertained and future goods passes to the consumer when the goods are in a deliverable state and 'unconditionally appropriated' to the contract. However, the definition of 'unconditionally appropriated' is open to interpretation. For example, in some cases, it may be considered sufficient for the product to have been set aside and labelled with the customer's name. However, in other cases this may be considered insufficient as the retailer could technically have later changed their mind and used those goods to fulfill another contract.<sup>8</sup>

Our clients' sense of confusion and injustice was again heightened in cases where the insolvent retailer was taken over by another business or the decision was taken to trade in administration. Clients could not understand why goods which they had already paid for, and had been told would not be delivered, were available for other consumers to pay for and take away.

*"We bought some doors from a retailer on 25 April. On 5 May, this company went into administration...I went into the store a week ago to find that exactly the goods we had paid for were on open sale! I asked if I could take the goods that were on sale in lieu of the ones we had ordered and paid for. I was told that I couldn't because the bar code on my order was not the same as the barcode on the goods that were for sale!! I think this is nothing but a pathetic excuse and wonder whether what they are doing is illegal."*

Some people were even offered the opportunity to pay for the same goods again. For example, one woman told us:

*"The girls in the shop told me to ring my bank, to see if I could get money back, they would ring me in next couple of weeks to let me know if they are taken over and if they might still get curtains delivered, then they could sell them to me again? "*

## The process for securing redress

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<sup>8</sup> Law Commission (2015) *Consumer Prepayments on Retailer Insolvency. A Consultation Paper*.

The final area in which we saw significant confusion is in relation to redress. As we have seen, retailer insolvencies can cause a great deal of confusion and anguish for consumers who have paid for goods in advance. It is vital that consumers in this situation receive clear, timely information on their rights and the steps they need to take to seek redress. Unfortunately, our analysis revealed that this is not always the case.

A number of clients reported receiving mixed messages around the time that the company became insolvent. In some cases they were wrongly given assurances in the first instance that they would receive their goods, and delivery would take place as scheduled. Delivery dates were often pushed back several times, with the trader making a number of different excuses before eventually admitting that they were unable to deliver the goods.

People also found that they were passed back and forth between the trader and the administrator, making it very difficult to get a clear picture of the situation and their next steps. For example, one man told us:

*"The retailer advised me that this is an instruction from the administrator, however the administrator, who have been very unhelpful, have advised that this is the store's decision and not theirs and I should take it up with the store. In the meantime, there are no advisers within the administrator available to speak to me as they are all allegedly at the trader's stores."*

As outlined above, consumers who make a prepayment using their credit card enjoy additional protections under Section 75 of the Consumer Credit Act. However, in some cases people who tried to exercise these rights were prevented from doing so because the administrator or retailer were unwilling or unable to provide them with written evidence that the retailer was insolvent and unable to fulfill their contract with the customer. For example:

*"I bought an oven from trader on 30th October to be delivered on 6th November. My credit card company is willing to accept a Section 75 Consumer Credit Act claim but they need trader to confirm that they did not deliver the goods. The retailer has confirmed on the phone that they will not be delivering the goods but refuse to put anything in writing, and the administrator also refuses to put anything in writing to me."*

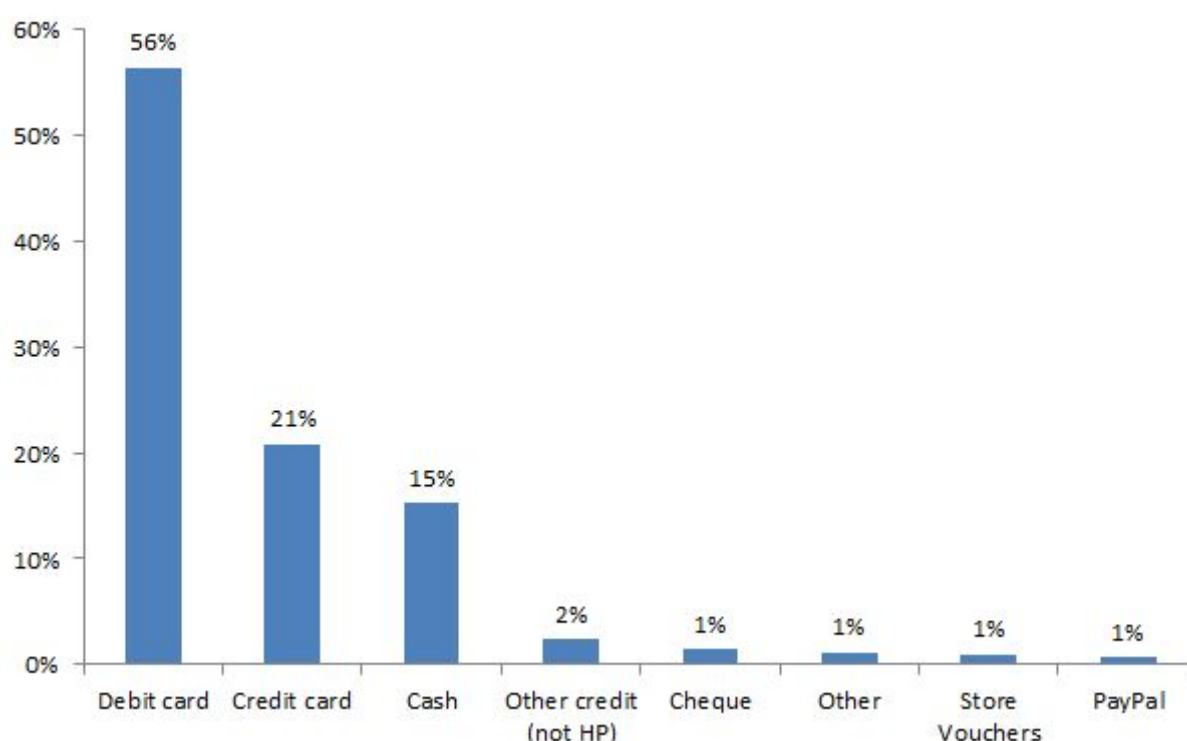
In many cases, claiming money back under Section 75 or through the chargeback scheme are the only routes to redress likely to result in a full refund. Our analysis found that three in four (77 per cent) of our clients had prepaid for their goods or services using a debit or credit card, and would therefore have



been eligible to apply for a refund from their debit or credit card issuer through one of these schemes. It is particularly important, therefore that consumers are made aware of their rights to apply for a refund under these schemes, and are given the evidence they need to support their claim.

**Figure 2: Three in four consumers made their prepayment by credit or debit card**

Method of payment used by callers to the Consumer Helpline to make a prepayment to an insolvent retailer



▲Source: Citizens Advice analysis of data from the Citizens Advice Consumer Helpline

The 15 per cent of our clients who made a prepayment using cash have fewer options when it comes to getting redress. Consumers who pay by cash also tend to be those on a low income who can least afford to absorb the financial shock of losing out on goods they have saved up to pay for. However, the Law Commission found that even in cases where money had been set aside to compensate consumers who had made prepayments, in trust or by the company taking over a business as a going concern, a significant amount of this money goes unclaimed. For example, Land of Leather put deposits worth £975,000 into a trust before they went into administration. Only 15 per cent of



this fund (£147,000) was ever claimed.<sup>9</sup> Once again, the need for clear information and signposting for consumers is paramount.

Some clear messages emerge from our analysis. First, there is a significant gap between consumers' expectations and the legal status and rights they are afforded in practice under insolvency law, leading to a strong sense of injustice among affected consumers. Second, the information given to consumers in the days and weeks after a retailer becomes insolvent is often incomplete and inconsistent. This makes it difficult for consumers to establish a clear picture of the routes to redress open to them and the steps they need to take to access them. Finally, access to redress is not consistent across payment methods, leaving consumers who pay by cash, who are often those least able to absorb financial shocks, at increased risk of finding themselves out of pocket.

In the next, and final, section we consider whether the law currently strikes the right balance between the interests of consumers and other creditors and explore potential opportunities for reform.

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<sup>9</sup> Law Commission (2015) *Consumer Prepayments on Retailer Insolvency. A Consultation Paper*.

## Section three: Opportunities for strengthening consumer protection

Our analysis revealed very few examples of a trader or administrator breaching current legislation. Instead, many of the calls to our service were prompted by frustration and disbelief that money paid upfront for goods and services in good faith could not be guaranteed in the event of retailer insolvency. Others called for advice after being given conflicting or incomplete information on the routes to redress open to them.

We recognise the need to balance the interests of consumers with the interests of other creditors, but our analysis suggests that the current settlement falls far short of consumers' expectations and common notions of fairness. In this section we focus in on the areas which seem most ripe for reform, weighing up the arguments and making a series of recommendations for change.

### 1. Amending the hierarchy of creditors

As outlined in section one, consumers who have made a prepayment to an insolvent retailer are afforded the status of unsecured creditors, putting them at the bottom of the pile when it comes to dividing up the retailer's assets. Despite the introduction of a requirement that a proportion of the assets, capped at £600,000, is set aside for unsecured creditors, in practice consumers received on average less than one pence for every pound they paid in the 31 retailer insolvencies analysed by the Law Commission.

This is unacceptable and significantly out of kilter with general principles of consumer rights. One way to redress this balance is to move consumers up the hierarchy of creditors and afford them the status of preferential creditors. There are three strong arguments for doing so:

First, as our analysis demonstrates, losing out on hundreds, and in many cases thousands, of pounds can have a significant detrimental impact on fragile household finances. These consumers have paid for goods and services in good faith and have not breached any terms and conditions of the contract. We do not believe that they should be penalised as a result of circumstances beyond their control.

Second, we recognise that other creditors have significant sums of money at stake, often far in excess of the amounts owed to individual consumers, and have a right to expect a fair share of any assets in cases of insolvency. However, the role of a bank or other firm extending credit is simply not the same as the role of a consumer paying for goods in advance. Creditors such as banks, finance companies and investors can reasonably be expected to undertake a credit check and take into account a wide range of indicators of a retailer's financial viability before taking the decision to lend the company money. They may also insist on securing any finance offered on the company's assets.

In contrast, consumers making a loan to the company in the form of a prepayment are unlikely to have access to, or the capacity to process, detailed information on the company's financial viability. Most companies are in a significantly stronger position to make an informed decision about the credit risk a retailer poses than consumers are, and can therefore be expected to take that risk into account in a way consumers cannot.

Moreover, as the Law Commission identifies in its consultation document, the current situation creates a perverse incentive for secured lenders to encourage retailers to continue trading, and to continue taking prepayments from customers, in order to build up the assets of the business even after it becomes clear that the company is in financial difficulty and is unlikely to be able to honour these contracts.<sup>10</sup> As our analysis identifies, many retailers continue to accept prepayments from customers in the days, and even hours, running up to their insolvency, by which time, customers felt, they must have known that they were unlikely to be able to deliver the goods. This is an act of bad faith on the part of the retailer and is not a practice that should be allowed to continue.

The Law Commission recognises the strength of these arguments and proposes that some, but not all, consumers should be afforded the status of preferential creditors. This group is currently limited to employees of the firm owed money for wages, pension contributions and holiday pay. These preferential creditors tended to receive the full amount owed to them in the retailer insolvencies analysed by the Law Commission. If consumers are added to the list of preferential creditors, there is a risk that preferential claims will no longer be paid in full because the assets available will be divided between a greater number of claimants.

The Law Commission therefore proposes that consumers would need to meet five strict criteria to be eligible for preferential status. The first and second

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<sup>10</sup> Law Commission (2015) *Consumer Prepayments on Retailer Insolvency. A Consultation Paper*.

proposed criteria specify that the claimant must be a consumer as defined in the Consumer Rights Act 2015 and that the claim relates to a prepayment which will not be honoured respectively. These criteria seem sensible. However, we have reservations about the final three criteria. The Law Commission holds that:

1. Preferential status should be limited to consumers who made a prepayment *during the three months leading up to insolvency*, by which time the financial problems facing the company are likely to become apparent. In practice, most goods and services paid for in advance are likely to have been delivered within three months. However, we see no compelling reason that consumers who paid for their goods more than three months in advance of the insolvency should be denied the same level of protection. We believe that there should be no time limit on a consumer's eligibility for preferential status.
2. Preferential status should be limited to those consumers with *a claim of £100 or more*. The justification given for this is the significant costs associated with administering a high volume of low value claims. However, we are concerned that limiting preferential status in this way would exclude the vast majority of consumers with unredeemed gift cards. The median value of gift cards in the cases we analysed was £30, well below the £100 proposed cap.

Furthermore, we are not convinced that the cost of processing small claims should have a bearing on the rights of consumers to be reunited with their money. It should not be impossible to run an efficient process for refunding consumers with valid gift cards. The onus to do this should fall on the administrator in line with their wider responsibilities to return assets to creditors. Consumers should not lose out because administrators don't currently have efficient systems to process such claims. It may be that the Department for Business, Innovation and Skills could work with insolvency practitioners to establish smarter ways of processing high volumes of small claims.

3. The consumer *used a payment method which did not offer a chargeback remedy*. This proposed criterion would exclude any consumers who paid by credit or debit card. The rationale for this is that superior routes to redress are open to credit and debit card holders in the form of Section 75 and chargeback. The Law Commission also note that retailers may find it more difficult to secure credit if too high a volume of consumer claims were placed above theirs in the event of insolvency, alongside the risk of some consumers making a double claim under both schemes.

We recognise these concerns, but have some reservations about the law differentiating between payment methods in this way. If preferential status for consumers is limited in this way, it is vital that legal safeguards are put in place to ensure parity of protection for consumers who have paid by credit or debit cards should section 75 protections or the chargeback scheme be removed or weakened at a later date. Steps must also be taken to ensure that consumers who have paid by credit or debit card are given ready access to the information and evidence they need to make a claim. As our analysis shows, this has not always been the case to date.

## **2. Encouraging retailers to take steps to protect consumer prepayments**

As we have already outlined, we believe that there is a strong moral and practical case for moving consumers up the hierarchy of creditors to the status of preferential creditors. However, the balance of risk assumed by consumers can also be reduced if more retailers take steps to legally ring-fence consumer prepayments in a trust. It is not always practical for retailers to set aside the full value of customer prepayments in trust as they often rely on these payments for cash flow. However, there are a range of different options, which offer varying levels of flexibility and protection which can be considered.

A number of trade associations have already taken positive steps to require their members to take steps to protect consumer prepayments in their codes of practice. The Consumer Codes Approval Scheme (CCAS), governed by the Chartered Trading Standards Institute (CTSI), has been at the forefront of this work - protection for consumer prepayments is a core requirement for codes seeking approval. However, to date only 14 industry codes, with 27,000 member businesses, have received approval through the CCAS, with patchy coverage across the country. The Government should therefore work with CTSI and consumer groups to encourage more trade associations to sign up to the scheme.

## **3. Greater clarity on the transfer of legal ownership of goods**

Our analysis reveals that confusion and a strong sense of injustice amongst consumers in relation to the point at which legal ownership of goods transfers to the consumer persists. Our clients found it particularly hard to comprehend that

the administrator or new owner could legally continue to display and sell goods which they had already paid for but would no longer receive. The Law Commission raised similar concerns in their consultation document and proposed that the law should provide greater clarity to retailer and consumers. They proposed the following:

*'For specific goods which are identified at the time of the contract, ownership should be transferred at the time the contract is made. This should apply even if the retailer has agreed to alter the goods in some way before the consumer takes possession.'*

*'For unascertained or future goods, which are not identified at the time of the contract, ownership should be transferred when goods are identified for fulfillment of the contract'.* This could include the item being set aside and labelled with the name of the customer or altered to the customer's specification.

This clarification is unlikely to address consumers' sense of injustice that goods identical to the ones they have paid for can be sold to other consumers when the retailer's stores continue to trade following insolvency. It would, however, give vital clarity to consumers, retailers and administrators and should lead to greater consistency in application. We therefore support this proposal.

#### **4. Clear information and a single point of contact for consumers.**

When consumers encounter a problem it is important that they are given clear, accurate information on their rights and the steps they need to take to secure redress. Unfortunately, our analysis revealed that when it comes to prepayments and retailer insolvency this was not always the case. In the cases we analysed, the confusion and frustration felt by consumers was often exacerbated by inadequate and sometimes conflicting information from administrators and retailers. Others found that they were passed back and forth between the retailer and the administrator, with neither willing to take responsibility for answering their questions.

The legal process of winding up a business and dividing up the assets is a complex and often lengthy process, during which the administrator or new owner will make a number of decisions, such as whether to honour gift cards and prepayments, which will materially affect the outcome for consumers. This can make it difficult to give definitive information to consumers in the days and

weeks following insolvency. There are some examples of good practice in this area, for example Deloitte publishes FAQs for consumers on its website alongside the information they are legally required to publish.<sup>11</sup> However, too often consumers are treated as an after-thought in the process, last in line when it comes to dividing assets and given the run around when they try to get the information they need to seek resolution.

The Government should therefore work with insolvency practitioners and consumer groups to draft guidance for administrators and merchant acquirers setting out the key pieces of information which should be provided to consumers at strategic points in the insolvency process. This should include information on whether the consumer will receive the goods or services they have paid for, a summary of the consumer's legal rights, routes to redress and signposting to impartial advice. People should also be given a single point of contact for all enquiries. This could be pursued as a voluntary commitment with industry in the first instance. However, the Government should not rule out the possibility of introducing statutory information requirements at a later date if necessary.

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<sup>11</sup> Law Commission (2015) *Consumer Prepayments on Retailer Insolvency. A Consultation Paper*.

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